

MUNICIPAL DEVELOPMENT PROGRAM

(GU-0134)

EXECUTIVE SUMMARY

Borrower: Government of Guatemala

Executing agency: Instituto de Fomento Municipal (INFOM)

		First Phase	Second Phase	Total
		(in millions of U.S. dollars)		
Amount and source:	IDB: (OC)	US\$ 9.5	US\$33.1	US\$42.6
	(OC/IFF)	US\$10.0	-----	US\$10.0
	Local:	US\$ 5.0	US\$ 8.3	US\$13.3
	Total:	US\$24.5	US\$41.4	US\$65.9

Financial terms and conditions:

Amortization Period:	20 years
Grace Period:	3.5 years
Disbursement Period:	3.5 years
Interest Rate:	Variable
Supervision and Inspection:	1%
Credit Fee:	0.75% p.a. on undisbursed balance
Currency:	US\$

Objectives: The overall goal of the Municipal Development Program is to advance Guatemala's decentralization program and strengthen the framework for promoting municipal development. In particular, the Program will promote a more equitable and efficient system for providing and financing municipal services. It will support reforms in the principal municipal development agency, INFOM, which will enhance its efficiency, procedures, and sustainability.

The Program has been conceptualized as a multi-phase operation, which will be implemented in two phases. Each phase is scheduled to take approximately three years to execute. This document requests approval of the two-phase approach and of a loan for Phase I of the Program. The recommendation for Board approval of Phase II of the Program would be triggered when the Bank verifies that (i) at least 50% of the loan resources for Phase I have been disbursed and (ii) the benchmarks presented in the Technical Annex have been achieved. A memorandum outlining the achievements of targets and performance benchmarks from Phase I, as well as any design modifications, a cost table and a

Description:

procurement plan for Phase II would be presented to the Board of Directors to request approval of the second phase of the Program.

The Program's underlying strategy sees larger and stronger municipalities working more in the future with the private sector to supply local services and finance infrastructure projects. For them, INFOM will play an increasingly indirect role, providing the information, services and cofinancing arrangements that encourage competition. Smaller, weaker municipalities (which will continue to be the majority) will continue to rely on INFOM as a major source of direct support. However, the Program will develop the incentives and technical assistance to help these municipalities "graduate" towards greater independence.

The Program has four components (a) Reforming INFOM and the municipal sector strategy, (b) Strengthening municipal capacity, (c) Promoting a competitive supply of private sector financing and services, and (d) Municipal infrastructure investments.

The present loan covers only the first phase of this two-phase Program with an estimated cost of \$27.7 million.

Reforming INFOM and The Municipal Sector Strategy (US\$3.7 million)

This component of the operation will support the implementation of reforms in three key areas: (i) a reorganization of INFOM; (ii) creating the program management capacity to carry out the Program; (iii) development of a Medium Term Municipal Strategy.

The Program will implement reforms to improve the efficiency, sustainability and procedures of INFOM and create conditions for a future shift in its role in the municipal sector. Reforms are in the areas of activity accounting, project costing, program monitoring and long-term planning.

In addition, studies will be carried out that the government of Guatemala will need to make decisions about the development of the municipal sector, in particular, institutional arrangements for municipal finance and coordination of development funding at the local level.

Strengthening Municipal Capacity (US\$3.5 million)

This component will finance two sets of activities. It will finance technical assistance to municipalities borrowing under the investment component, or simply requesting technical assistance, to implement institutional arrangements for local service provision and other management reforms. Resources are provided to carry out initial diagnoses and to provide technical assistance to implement the changes.

The component will also support INFOM's activities as manager of the National Municipal Training Plan. In this position, accorded to INFOM in the Peace Process, INFOM—through a network of training providers called RENICAM—organizes basic training for municipalities throughout the country by Department, in areas such as municipal law, service provision and tax collection, and in the modernization of accounting and budgeting.

Promoting Competitive Supply of Private Financing and Services (US\$0.6 million)

This component will support design and implementation of instruments that will promote a larger and more competitive supply of services and financing from the private sector.

Under this component, activities will be undertaken to (i) improve information available about the municipal sector, including the development of a system to evaluate municipal creditworthiness, (ii) facilitate the expansion of private lending by piloting new cofinancing arrangements with private lenders, and (iii) clarify the legal framework, develop policies for municipal finance, and propose reforms.

Municipal Infrastructure Investments (US\$16 million)

The investment component will allow municipalities to continue to invest in projects with adequate social return and provide an incentive to all the actors to institute policy and institutional reforms, including the implementation of (i) new institutional arrangements for service provision, (ii) new INFOM lending policies and (iii) new policies governing the uses and allocation of subsidies, including the overriding policy that all subsidies will be explicit and provided to municipalities only as a capital subsidy to projects.

Municipalities will be evaluated to determine both their financial and institutional readiness to borrow under the terms of the Program. With technical assistance, a series of institutional arrangements and management improvements will be made to ensure the sustainability and quality of the services. Once ready, municipalities will borrow under the terms of new financial policies mentioned above.

**Relationship of
Project in Bank's
country and
sector strategy:**

The project conforms to the Bank's local development strategy for the country, which seeks to support the decentralization process, promote local development and increase the coverage, quality and efficiency in the delivery of basic services. The project advances the Bank's sector strategy, by attempting to reform the practices of a Bank-supported municipal development fund to allow it to serve as a transitional mechanism in the development of a disciplined municipal finance system.

**Environmental/
social review:**

The proposed project will ensure the implementation of environmental procedures for municipal projects more consistent with current national policy, and design the institutional arrangements to support these changes. A consultancy will be arranged to evaluate the environmental impact of a sample of previously executed projects and help INFOM, municipal representatives and CONAMA implement new environmental review procedures. INFOM's institutional capacity will be strengthened through the creation of the Environmental Office and technical assistance will be provided to support the municipal effort to carry out the agreed procedures.

Participatory processes in project planning, approval and implementation will be strengthened through the use of several measures under the Program, including new procedures for selecting and managing municipal projects and allocating subsidies. RENICAM members with expertise in participatory techniques will provide training for municipal officials and community leaders, including women and indigenous people.

Benefits:

The Program will produce interrelated benefits in three areas: within the municipalities at the local level, for the municipal sector as a whole and within INFOM.

At the local level, citizens will have expanded opportunities to participate in the identification of projects and the setting of tariff and service levels, and the projects financed will be more sustainable. New institutional arrangements will allow decisions regarding service improvements to be more technical and less political. The finances of a large group of municipalities will be improved, including those borrowing from INFOM. Poorer municipalities will benefit from the new approach to subsidy allocation. Municipalities and their citizens will also have benchmarks to evaluate progress, using credit evaluations and a system of performance monitoring indicators.

The Program will produce improvements in the quality and quantity of information about the municipal sector available to private lenders and others, and will design and pilot new models of municipal financing and public/private participation. These measures will promote a more diversified, competitive supply of financing and services for municipalities.

INFOM's capacity to support the municipalities in their execution of infrastructure projects will be enhanced. Its ability to manage its operation will be improved, as will its own sustainability. As the government evaluates its options for expanding municipal finance and other forms of support to municipalities, these reforms will create a platform for a future significant role for INFOM in the Guatemalan municipal sector.

Risks:

The success of the operation depends critically on INFOM's continued commitment to a transition towards a new role in the municipal system. It also requires the simultaneous implementation of a range of new procedures and policies. To mitigate this latter risk, the Program provides extensive management support.

The transformation of municipalities into financially autonomous and creditworthy institutions is complicated by their weak financial condition and the flows of nonreimbursable funding invested in the municipalities by the Social Investment Funds. While the current government has expressed its support for a process to better rationalize the current funding framework, INFOM has little or no formal authority over the other agencies involved.

The Program seeks to encourage a wider role for private capital and private enterprises in the municipal system. However, the Guatemalan financial sector is weak and volatile, and its credit evaluation practices are poor. The sector has little access to long-term investment resources. The lack of standardized arrangements for urban service provision makes it expensive to work in the sector, especially with smaller municipalities. How the private sector will respond to the measures taken in the Program will depend on factors, such as the macroeconomy and the condition of the financial sector, over which neither INFOM nor this Program have any control.

**Special
contractual
clauses:**

Conditions prior to first disbursement

Prior to first disbursement of the financing, INFOM will present to the satisfaction of the Bank:

- ~~✍~~ Evidence that it has signed a subsidiary agreement with the Ministry of Public Finance, in accordance with a text previously agreed upon with the Bank, which contains, among other things, a definition of how the Program funds will be transferred to INFOM and the commitment of INFOM to execute the Program as agreed by the Government of Guatemala and the Bank (Par. 3.1).
- ~~✍~~ Evidence that INFOM has contracted the Program Coordinator and the Financial Advisor in accordance with terms of reference previously agreed upon with the Bank (Pars. 3.2; 3.15)
- ~~✍~~ Evidence that it has contracted, in accordance with terms of reference previously agreed upon with the Bank, the consultants to design and implement the accounting system reforms (Par. 3.7).

- ~~✍~~ Evidence that it has contracted, in accordance with terms of reference previously agreed upon with the Bank, the consultants to design the performance monitoring system for all components (Par. 3.9).
- ~~✍~~ Evidence that the institutional reorganization necessary for the implementation of the Program, including creation of the Technical Studies Unit and establishment of the Management Coordination Group, has been approved by the INFOM Board of Directors and is operational (Par. 3.24).
- ~~✍~~ Evidence of the establishment of the Interinstitutional Working Group for analyzing national policy options in the area municipal financing and interinstitutional coordination and approval of its work plan for Phase I. (Par. 3.8).
- ~~✍~~ The final version of the Operating Regulations of the Program (Par.3.34).
- ~~✍~~ The model contract to be signed by INFOM and the municipalities for the execution of Component 4 of the Program, prepared in accordance with text previously agreed to by the Bank (paragraph 3.20).

Other conditions

Conditions appropriate for this type of operation, as well as those pertaining to audits, reports, and monitoring and the establishment of a 10% revolving fund will also be agreed upon.

**Poverty-targeting
and social sector
classification:**

This operation does not qualify as a social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (Document AB-1704).

**Exceptions to
Bank policy:**

See paragraph on procurement.

Procurement:

It is proposed that municipalities be permitted to execute works costing up to US\$125,000 by direct contracting, provided that the total amount does not exceed 10% of the financing for Component 4 of the program (paragraph 3.49).

International competitive bidding will be required for consulting services in excess of US\$200,000, goods and related services in excess of US\$250,000 and construction works in excess of US\$1,500,000. National competitive bidding will be required for works between US\$250,000 to US\$1,500,000, goods and services between US\$150,000 and US\$250,000 and consulting services between \$150,000 and \$200,000. Local competitive bidding (shopping) will be applied to works under US\$250,000, goods and services under \$150,000 and consulting services under US\$150,000.

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